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**Legislation and Case Law:  
Provisional Profit in Iran's Banking System: Same  
Meat, Different Gravy**

*by Ehsan Allagheband Hosseini*



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Zurich** <sup>UZH</sup>



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# Legislation and Case Law: Provisional Profit in Iran's Banking System: Same Meat, Different Gravy

by Ehsan Allagheband Hosseini\*

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## Abstract

*The foundation of an Islamic country and the implementation of Islamic laws were the primary goals of the Iranian Islamic Revolution of 1979. Many laws and regulations were changed and revised in order to conform to Shari'ah law. Therefore, one of the most critical laws adopted after the Revolution and rooted in Shari'ah law, which strictly forbids riba (interest), is the Riba-Free Banking Act of 1983. After three decades, a case can be made that it has not been entirely successful in eliminating riba from Iran's banking system. While all Iranian banks allegedly follow the prohibition of riba, in practice they cannot afford to fully adopt the Islamic doctrine in this manner. With practical work experience in a financial institution in Iran, I thoroughly understand the distance between theory and the reality of the riba-free banking system in Iran. Specifically, with study and review of term investment deposit accounts, we argue that post-revolutionary changes in the banking system of Iran did not result in the so-called elimination of riba from Iran's financial structure. Iranian banks continue to pay a fixed and predetermined interest in the form of a new phrase: provisional profit.*

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## I. Introduction

Foundation of an entirely functional Islamic country and the implementation of Islamic laws were the primary goals of the Iranian Islamic Revolution of 1979. Precipitant process of Islamization of Iran started right after the fall of the Shah of Persia. Necessary measures were taken to build an Islamic country. Many laws and regulations were changed and revised in order to conform and harmonize with Shari'ah law. Shari'ah law provides directions for all spheres of Muslim life including daily affairs, matrimony, rituals, politics, and family obligations and, of course, provides instructions for financial activities as well. Therefore, Shari'ah plays an indispensable role in the governance of banking activities in the Islamic Republic of Iran. One of the most important and critical laws adopted after the Revolution that was rooted in Shari'ah law, forbidding *riba* (interest) is the *Riba-Free Banking Act* of 1983. The Act is drawn up so as to ensure that the banking system of Iran complies with Shari'ah rules. After three decades of its adoption, a case can be made that it is not entirely successful in eliminating *riba* from the Iran's banking system. While all of the banks and financial institutions in Iran allegedly follow the prohibition of *riba*, in practice they cannot afford to fully adopt the Islamic doctrine in this manner. With actual work experience in a financial institution in Iran, I thoroughly understand the distance between theory and practice of the *riba-free* banking system in Iran. Specifically, with the study and review of the term investment deposit accounts, we argue that post-revolutionary changes in the banking system of Iran did not result in the so-called elimination of *riba* from the country's financial structure. Iranian banks continue to pay a fixed and predetermined interest known by a new phrase: 'provisional profit'.

In the first part of this paper, we briefly define *riba* and its prohibition in Islam and expound on the *Riba-Free Banking Act* of the Islamic Republic of Iran. Muslim and non-Muslim scholars have written *ad nauseam* in this regard, and different aspects of *riba* and Islamic banking have been described in detail.<sup>1</sup> However, the fact that Iran's banking system continues to follow interest-based banking and how it found a way to circumvent the Act has never been studied. Accordingly in the second part of this paper, we exclusively study term investment deposit accounts.

## II. Riba

The word *riba* means 'increase' as interpreted by Imam Razi. It corresponds to the word 'interest' as defined by Webster's New World Dictionary.<sup>2</sup> In both cases, increase refers to the amount beyond what is owed.<sup>3</sup> In Arabic language, *riba*, is also known as 'usury', which means excess or addition, an effortless profit, the 'premium' that must be paid by the borrower to the

<sup>1</sup> For further study, see: THOMAS ABDULKADER, *Interest in Islamic Economics: Understanding Riba*, London/New York 2006; RAHMAN FAZLUR, *Riba and Interest*, *Islamic Studies* 1964, Vol. 3, No. 1, 1-43; AHMAD ZIAUDDIN, *The Theory of Riba*, *Islamic Studies* 1978, Vol. 17, No. 4, 171-185.

<sup>2</sup> As defined by Webster's New World Dictionary, interest means: "a charge for borrowed money generally a percentage of the amount borrowed".

<sup>3</sup> SIDDIEQ NOORZOY M., *Islamic Laws on Riba (Interest) and Their Economic Implications*, *International Journal of Middle East Studies* 1982, Vol. 14, No. 1, 3-17, at 3.



lender along with the principal amount as a condition for the loan or for an extension of its maturity, a tool of oppression, and a means to unjustly take the money of others by exploiting their needs and circumstances.<sup>4</sup> Prohibition of *riba* is one of the core subjects and distinctive features of Islamic beliefs and is widely reflected in the Holy Qur'an and Hadiths.<sup>5</sup> The prohibition of *riba* is mentioned in four different chapters (Sura) in the Holy Qur'an. These are Sura Al-Baqara (Chapter 2: verses 275 – 280), Sura Al-Imran (Chapter 3: verses 130 – 132), Al-Nisa (Chapter 4: verse 161), and Al-Rum (Chapter 30: verse 39). To avoid rehash, we mention just two important verses in this context:<sup>6</sup>

"And if you do not [abandon what remains of usury], then be informed of a war from Allah and His apostle. And if you repent, then you will have your principal, neither harming others, nor suffering harm."<sup>7</sup>

"And for their taking usury though they had been forbidden from it and for eating up the wealth of the people wrongfully. And We have prepared for the faithless among them a painful punishment."<sup>8</sup>

There are also many Hadiths on the prohibition of *riba*.

"The Prophet said: *riba* has seventy segments, the least serious being equivalent to a man committing adultery with his own mother."<sup>9</sup>

"The Prophet said: the receiver and the payer of *riba*, the one who records it and the witness to the transaction, they are all alike in guilt of this sin."<sup>10</sup>

By studying the Holy Qur'an and Hadiths, we note that the attitude of Islam toward *riba* is far harsher than for other sins such as adultery, alcohol consumption, gambling, cruelty, and murder<sup>11</sup> in so far as it is considered blasphemy and receivers of *riba* have been declared to be at war against Allah and Mohammad (His Messenger). The Holy Qur'an provides no explanation as to why *riba* is prohibited, and different reasons have been purported by Islamic scholars and jurisprudence throughout history. In this paper, the reason behind the prohibition of *riba* is not discussed.

<sup>4</sup> BOTIS SORINA, Shari'ah Concepts in Islamic Banking, Bulletin of the Transilvania University of Braşov, Series V: Economic Sciences 2013, Vol. 6 (55) No. 2, 139-146.

<sup>5</sup> A collection of traditions containing sayings of the prophet Muhammad, which constitute a major source of guidance for Muslims apart from the Qur'an.

<sup>6</sup> The verses are from The Holy Qur'an: Translation and Commentary (1934) by Abdullah Yusuf Ali.

<sup>7</sup> Sura Al-Baqara, Chapter 2: Verse 278.

<sup>8</sup> Sura Al-Nisa, Chapter 4: Verse 161.

<sup>9</sup> AL-AAMILI SHAIKH AL-HUR, وسائل الشيعة الى تحصيل مسائل الشريعة (Wasā'il al-Shī'a), Qom 1993, Vol. 18, at 122.

<sup>10</sup> AL-AAMILI, *supra* n. 9, at 126.

<sup>11</sup> HUSSAYN TABATABAEI MUHAMMAD (Allameh Tabatabaei), الميزان (Tafsir al-Mizan), Qom 1417 AH, Vol. 2, at 628.

### III. Riba-Free Banking Act of the Islamic Republic of Iran

Gradually, after the Islamic Revolution of 1979 and the nationalization of Iranian banks,<sup>12</sup> reception of any kind of interest faded away from Iran's financial system. With the adoption of Iran's Riba-Free Banking Act in 1983, for the first time in modern history, the Islamization of the banking system was implemented in the financial sector of the economy as a whole.<sup>13</sup> As Ayatollah H. Rafsanjani expressed, "this Act was adopted to found a system of *riba*-free banking in the Muslim world."<sup>14</sup> However, after three decades, the major question still looms large as to whether this Act has been able to go beyond the idea of Islamic banking and implement Islamic principles in Iran's banking system. In this paper, we argue that the Riba-Free Banking Act has failed to fulfill its duty in practice and *riba* emerged in Iran's banking system, with a new face called provisional profit. Later, using empirical examples of term investment deposits and the provisions currently being used by the banks and financial institutions in Iran, we argue that this so-called provisional profit is *riba* in the context of Islamic finance.

The first chapter of the Riba-Free Banking Act expresses the goals and duties of the banking system of the Islamic Republic of Iran. Sections 8 and 9 of Art. 2 of this chapter relate directly to our discussion. They state that:

"[...]

8. [Banks have the duties of] Opening of various Gharz-al-hasaneh (current and savings) accounts and accepting Term Investment Deposits and issuance of relevant certificates, as required by the Act and the regulations.

9. [Banks have the duties of] Granting of loans and credits free of *riba* charges in accordance with the Act and the regulations."

These two sections of Art. 2 perfectly describe and define the core functions of banks as financial intermediaries in Iran's financial system. Religious philosophy aside, from a functionalist perspective, there is no difference between Iranian banking and conventional banking. In both systems, banks raise funds by opening different types of accounts and taking deposits and grant these funds to those who need them. The difference lies within the implementation of these functions. In contrast to conventional banking, when performing their roles, Iranian banks must follow the Islamic principle on the prohibition of interest and Qur'anic injunctions against *riba*. Obviously, prohibition of *riba* has a major effect on both classic functions of banks. In the next section, we closely study the concept of term investment deposits as a common tool for the mobilization of monetary resources and examine how Iranian banks cope with the Islamic principle in practice.

<sup>12</sup> Nationalization of Banks Act approval by Revolutionary Council dated June 1979.

<sup>13</sup> VALIBEIGI MEHRDAD, Banking and Credit Rationing Under the Islamic Republic of Iran, *Iranian Studies* 1992, Vol. 25, No. 3/4, 51-65, at 56.

<sup>14</sup> KASHANI MAHMOOD, چالش‌های قانون بانکداری ایران (Problems in the Iran's Banking Law), *Legal Research Journal* 2005, Vol. 42, 11-68, at 23.

## IV. Term Investment Deposits

Art. 3 of the Riba-Free Banking Act authorizes Iranian banks to accept deposits under each of the following titles: (A) Gharz-al-hasaneh Deposits: 1-current and 2-savings and (B) term investment deposits. According to this article, term investment deposits, for which the bank enjoys the power of attorney for their utilization, shall be used in Mosharka, Mozarebeh, hire-purchase, installment transactions, Mozara-ah, Mosaqat, direct investment, forward dealings, and Joalah transactions. Art. 5 states that the profit from said transactions (the ennealogy Islamic contracts), proportional to the duration and amount of the investment deposit, should be divided among the owners after deduction of the bank's expenses and fees.

Thus, on the basis of the above provisions of this Act, Iranian banks, under the terms of the agency contract, act as agents of the depositors to invest the deposited funds in said transactions (the ennealogy Islamic contracts). Upon completion of the contract period and final calculation, the profits (losses) are shared between the agent (the bank) and the entrepreneur. Therefore, the bank's profits and consequently the profits of their client (the depositor) are not at all assured or secured. For example, when opening a long-term investment deposit with Saman Bank (a famous privately owned Iranian bank), under the conditions of the long-term investment deposit account:

"Saman Bank as the agent of the long-term investment depositor, with full power of substitution, in accordance with the Riba-Free Banking Act can invest the depositor's funds. The profit of said investment after the deduction of the bank's fees, conforming to the relevant regulations and rules and proportional to the duration and amount of the investment deposit, shall be paid to the depositor or his substitute."

Further, according to the conditions for long-term investment deposit account stipulated by Bank Maskan (an Iranian government-owned bank):

"Bank Maskan, on behalf of and as an agent of the depositor, use the deposited funds in accordance with the Riba-Free Banking Act and the profit, conforming to the relevant regulations and rules, will be paid, with the right of compromise, proportional to the duration and amount of the deposited fund."

All Iranian banks and financial institutions have the same clause in their agency contracts with more or less similar wording.

Most Islamic contracts are based on profit-and-loss-sharing (PLS) and not on a lender-borrower relationship, and Islamic law demands that the provider of funds should share the risk with the entrepreneur if he wishes to earn a profit.<sup>15</sup> There are no guarantees that there will always be a profit in most of the said contracts. The PLS scheme is inherently risky while bank investment depositors are generally ordinary, risk-averse people who desire a fixed, decent, and risk-free income from their investment deposits. However, in Islamic banking, investment

<sup>15</sup> ROY DELWIN A., *Islamic Banking*, Middle Eastern Studies 1991, Vol. 27, No. 3, 427-456, at 431.



depositors are treated as if they are shareholders and are thus entitled to a share of the profits or losses made by the bank<sup>16</sup> as their agent. In addition to the high-risk nature of these transactions, this method of banking demands that profit (or loss) should be divided at the end of the Islamic contract period between the bank and the entrepreneur. In other words, Iranian investment depositors face two risks; first of all, there is no guarantee that any profit will be made. Second, let us assume for the sake of argument that the bank makes a profit. In such case, there is still no immediate profit payment to the investment depositors. The assumed profit is paid at the end of the contract period. These two high-risk features of Islamic banking, without a doubt, increase uncertainty and change the savings behavior of the Iranian people. Lack of motivation to invest money in term investment deposits would result in liquidity crisis, which would place banks in a poorer position.

Islamic law forbids fixed or predetermined returns on financial transactions, not an uncertain rate of return represented by profit.<sup>17</sup> Therefore, Iranian banks needed to design an investment deposit model in which the existence of predetermined interest is ruled out but still attractive and secure enough for Iranian citizens to invest. To solve the motivation problem and create sufficient assurance among investors, Iran's banking system adopted the strategy of provisional profit payments. Provisional profit is a predetermined and fixed amount of money paid prior to the expiration of the ennealogy Islamic contract period and calculation of final profit (or loss).<sup>18</sup> Paying this predetermined and fixed profit (i.e., provisional profit), with the current terms and conditions, makes the Iranian banking system equivalent to an interest-based banking system.

## 1. Provisional Profit in Iran's Banking System

According to Art. 4 of the Riba-Free Banking Act, banks may undertake and/or insure the principals of term investment deposits. However, no single article in the said Act or its regulations points to provisional profit payments. Art. 10 of the Implementing Regulations of the Act passed on December 18, 1983 by the Cabinet prohibits the payment of any kind of predetermined profit to Term Investment Depositors. To highlight the importance of this rule, even the Implementing Guideline of the Act, passed by the Money and Credit Council on February 27, 1983, expresses this dictum. Art. 14 states:

“The banks cannot *declare* and/or *pay* any predetermined profit to Term Investment Deposit accounts.”<sup>19</sup>

Despite this explicit stipulation in Art. 14, Art. 21 of the same Implementing Guideline surprisingly uses the phrase provisional profit for the first time in the history of banking in Iran. This article authorizes banks to pay provisional profit in specified circumstances. As discussed above, after the expiration of the agency contract period, the final and actual profits

<sup>16</sup> KHAN MOHSIN S./MIRAKHOR ABBAS, *Islamic Banking: Experiences in the Islamic Republic of Iran and Pakistan*, *Economic Development and Cultural Change* 1998, Vol. 38, No. 2, 353-375, at 355.

<sup>17</sup> KHAN/MIRAKHOR, *supra* n. 16, at 354.

<sup>18</sup> JALILI HOSSEIN MIR, مسائل بانکداری بدون بهره در تجربه ایران (Interest-free Banking Experience in Iran), *Research and Economic Policy* 2002, Vol. 22, 127-152, at 128.

<sup>19</sup> Emphasis added by the author.

(losses) are shared between the bank and the entrepreneur. According to this article, however, if the client, prior to the expiration of the contract period, decides to dissolve the agency contract, "the profit will be calculated on a provisional basis, and the final and actual profit will be paid at the end of the fiscal year." Therefore, payment of any kind of provisional profit is evidently supposed to be a simple solution in cases of dissolution. This exceptional solution should not be generalized and extended whatsoever.

It has been proven many times throughout human history that *Necessitas non habet legem*, and certainly Iran's banking system cannot change this hard-set rule. On January 15, 1992, Iran's banking system took a giant leap toward interest-based banking. The Money and Credit Council, at its 758<sup>th</sup> session, in order to create a safe and secure investment environment, decreed that: "[T]he granting of any kind of benefits and profits such as guaranteed profit, *provisional profit*, [...] are clear examples of banking, monetary and credit activities that banks and credit institutions who are authorized by the Central Bank of the Islamic Republic of Iran are permitted to do."<sup>20</sup> Although the Money and Credit Council, as one of the pillars of the Central Bank, is "in a position to consider and decide on the general policy of the Central Bank of the Islamic Republic of Iran and to supervise the monetary and banking affairs of the country"<sup>21</sup> it unquestionably cannot enact a regulation that violates the letter or the spirit of the Riba-Free Banking Act. Enactment of such regulation is a blatant violation of Islamic banking, which is formed on the basis of necessity. In consonance with the said regulation, Iranian banks explicitly and impudently undertake to pay a monthly provisional profit to depositors. For example, Saman Bank's agreement states: "The share of long-term investment profits, according to relevant regulations, is calculated provisionally and will be paid on a monthly basis to the depositor's account. The final settlement in respect of the actual profit shall be made at the end of each fiscal year."

In past years, the Money and Credit Council has determined various rates for provisional profit. The provisional profit rate is always a function of the inflation rate. Currently, under a directive of the Money and Credit Council dated June 24, 2014,<sup>22</sup> the provisional profit rate is as follows:

Maximum Provisional Profit Rate of Investment Deposit Accounts in Iran's Banking System	
Type of Deposit Accounts	Percentage of Annual Provisional Profit
Short-Term Deposit Investment Account	10.0
Short-Term Deposit Investment Account (Three Months to Less than Six Months)	14.0

<sup>20</sup> Emphasis added by the author.

<sup>21</sup> Article 18 of the Monetary and Banking Act of Iran, adopted on July 9<sup>th</sup> 1971 and revised on January 11, 2014.

<sup>22</sup> Central Bank of the Islamic Republic of Iran, Press Release, available at <http://www.cbi.ir/showitem/11923.aspx>, last accessed on 28 December 2015.

Short-Term Deposit Investment Account (Six Months to less than Nine Months)	16.0
Short-Term Deposit Investment Account (Nine Months to Less than One Year)	18.0
Long-Term Deposit Investment Account (One Year)	22.0

## 2. Legal Nature of Provisional Profit under Shari'ah Principles

As discussed above, until the expiration or dissolution of the agency contract, depositors are not entitled to receive any kind of profits (losses). So the main question is how to justify the legal nature of provisional profit under Shari'ah's financial principles.

Basically, the concept of provisional profit is that a bank pays a fixed and predetermined profit to a depositor provided that after the final calculation and determination of each party's share (the bank as the agent and the entrepreneur), if the amount paid as provisional profit is less than the actual and final profit, the bank will pay the differential amount to the depositor. However, if the actual and final profit is less than the provisional profit, the depositor must return the differential amount to the bank. Contrary to interest-based banking, where the interest immediately becomes the lender's property without any element of consideration or conditions, the ownership of provisional profit does not unconditionally pass to the depositor and the depositor is obliged to return the differential amount to the bank. This conditional transfer of ownership means provisional profit is more like a loan. By way of explanation, when opening a term investment deposit account, two contractual relationships are formed between the bank and the customer. Based on the first explicit relationship, under the agency contract, the customer appoints the bank as his representative for investment. Under the second relationship, the bank loans a monthly fixed and predetermined amount of money to the depositor. This regular payment in the form of an implicit loan contract creates sufficient incentive among depositors to keep their fund in deposit accounts. After determining the agent's (the bank's) share of the final profit on the investment, the bank—after deducting of expenses and fees—gives the final profit to the principal (the depositor).

On the other hand, the depositor must also pay off his loan to the bank. Consequently, when two parties are indebted to one another at the same time, their debts are annulled by a set-off to the extent of the amount owed by both parties. To that extent, the parties are released from their mutual debts.<sup>23</sup> Finally, if, after the set-off, one party still owes money to the other, the debtor must settle his account.

As long as the Iranian banks are committed to the theoretical principals of this approach (as described above), the elements of insecurity and instability will be the main hallmarks that

<sup>23</sup> The Civil Code of the Islamic Republic of Iran (1935), Art. 295.

distinguish provisional profit in Islamic banking from interest in conventional banking. Insecurity and instability mean that depositors have no assurance that any profit will be made and the rate of profit remains unknown. Theoretically, it is possible that after the final calculations, depositors who participate in investment may lose all their funds and hence must restore the total amount of provisional profit to the bank. As a result, "the cost of being a Muslim"<sup>24</sup> can be extraordinary high for ordinary Iranian citizens.

### 3. Provisional Profit in Practice

The current and actual practice of Iranian banks in light of the provisional profit payment scheme is paradoxical to the Islamic injunction against *riba*. The difference between 'provisional profit' and 'interest' is not supposed to be a mere technicality or choice of vocabulary. There is a profound conceptual difference between these two approaches. The elements of insecurity and instability mentioned above are the key fundamental distinction. If these indispensable elements are detached from the scheme, we will only have a rhetorical dichotomy or, in the words of Mr. DELWIN A. ROY, "[a] cosmetic operation that may show an Islamic bank's inability to perform in a truly Islamic manner."<sup>25</sup>

Practical procedures of Iranian banks in the years following the adoption of the provisional profit scheme absolutely eliminated the elements of insecurity and instability. Performance of the banking system in Iran over the last 23 years, especially the method of calculating final and actual profit, has created and shaped a surety and certainty in society that provisional profit is indeed actual profit. During these years, there has not been a single case of withdrawal of extra profit from depositors. Oddly enough, not a single case in which actual profit is less than provisional profit is on record. It has been consistently proven that the most skilled financial and investment experts make mistakes in predicting the investment environment but surprisingly, Iranian banks have always been profitable and paid provisional profit as the minimum final and actual profit. Undoubtedly, the reason for this is to keep customers satisfied and avoid losing funds. However, this practice of Iranian banks has caused depositors not to consider provisional profit as a temporary loan.

The result is that the crucial elements of insecurity and instability are separated and detached from the scheme. Provisional profit is calculated based on the simple above-mentioned rate formula and is paid on a monthly basis to depositors. Depositors have no obligations or responsibilities to banks. They regularly receive their provisional profit, and Iranian banks set provisional profit rates and treat them as the final profit rates at the end of the fiscal year. Many people are not even aware of the provisional profit structure. As far as they are concerned, they like to receive a monthly fixed and risk-free income from their investment. In the current banking system of Iran, provisional profit has the same meaning and function as interest in conventional banking. As one of Iran's current Parliament members said: "Provisional profit is just an estimated figure so the depositors know the ballpark figure of the profit they are going to make. Of course, after auditing, the actual profit should be announced

<sup>24</sup> ABDUL-RAHMAN YAHIA, *The Art of Islamic Banking and Finance: Tools and Techniques for Community-Based Banking*, New Jersey 2010, at 199.

<sup>25</sup> ROY, *supra* n. 15, at 431.

and the final profit rate will necessarily vary from the provisional profit rate.”<sup>26</sup> The current scheme, regardless of the name chosen for it, contains a fixed predetermined risk-free rate of return on investment and definitely does not differ in essence and nature from the interest-based system.

## V. Solution

In accordance with the Act and regulations, funds obtained by banks from investment deposits can be used through *ennealogy* Islamic contracts. These *ennealogy* contracts can be simply divided into two categories: The first category is based on the PLS scheme and includes *Mosharka*, *Mozarebeh*, *Mozara-ah*, *Mosaqat*, *Joaalah*, direct investment, and forward dealings. In this category, entrepreneurs are not guarantee a predetermined and fixed profit, and financing operations are based on an unknown rate of return derived from the PLS. The second category consists of hire-purchase contracts and Installment Transactions. As defined in Art. 47 of the Implementing Regulations, a hire-purchase contract is a lease contract in which the bank purchases goods for their clients and under the conditions stipulated in the contract, ownership gradually passes to the tenant with the payment of installments. The same scenario is true in the case of installment transactions. The rent in hire-purchase contracts and sales prices in installment transactions are determined by taking the bank's cost and profit into account. Thus, contrary to the first category, the rate of return is clear and defined at the initial stage.

The difference between the bank's profits in the first category and profits in the latter category is quite obvious. In the first category, banks *are expected* to make a profit. There is no guarantee that such profit will be made, as profits may be much greater than the expected sum. This is the nature of the PLS scheme. However, in the second category, the bank's profits are guaranteed and the entrepreneur must pay the guaranteed profit, which means there is no risk.

To fully adapt to Shari'ah principles and solve the *riba* dilemma, the Iranian banking system should design two types of accounts. The first type should be based on the PLS scheme (the first category of contracts as mentioned above). There is no predetermined and fixed profit for this type of account so it is suitable for those who wish to take more risk to make more profit. On the other hand, the second type is a risk-free account. This type of account is based on the second category of contracts. These contracts have a fixed rate of return and are fully be functional in the framework of Shari'ah principles and the Act as they are not based on the PLS scheme. For this type of account, banks are not participating in a risky business with an unknown rate of return. However, determination of a fixed profit rate is not prohibited in these accounts. Thus, Iranian Banks can pay a fixed and definite profit at specified intervals to depositors. This is precisely why the problem of provisional profit payments is avoided in these accounts. Without a doubt, the amount of profit in this type of account is reduced compared to the amount in the first type of account. However, to build a fully Islamic financial system, Muslims must pay the price and cannot have the best of both worlds.

<sup>26</sup> Islamic Consultative Assembly News Agency, available at <http://www.icana.ir/Fa/News/255195>, last accessed 28 December 2015.



## VI. Concluding Remarks

Islamic banking has always tried to provide an alternative to conventional banking systems. They both have the same function in societies. In other words, all roads lead to Rome. However, the Islamic banking road has its own characteristics and requirements. The Islamic injunction against *riba* has major effects and outcomes on the deposit side of Islamic banking activities. The post-revolutionary financial system of Iran, as a front runner of Islamic banking, has tried to design a risk-free Islamic investment deposit account based on the PLS scheme in which depositors can receive profits on a monthly basis, which is quite similar to interest-based banking. Thereupon, Iranian banks came up with the provisional profit payment scheme. The current scheme totally changes the structure of PLS and makes it a risk-free and safe business. The contemporary practice of provisional profit is contrary to the principles of Shari'ah. It is easy to infer that Iranian banks have tried to prevent a cash-flow problem.

The Act should be amended. To honor Islamic values, the financial system of Iran needs to incorporate two types of accounts: one based on the PLS scheme, where depositors share profits and losses in proportion to their fund contributions, and the other one based on the hire-purchase contract and installment transactions with a fixed rate of return, where depositors receive risk-free, fixed, and definite monthly profits.